

INVESTMENT POLICY
of the
Metropolitan Government of Nashville & Davidson County

SCOPE OF THE INVESTMENT POLICY

This investment policy is a comprehensive one that governs the overall administration and investment management of those funds held in the Short-Term Investment Portfolio (the "Portfolio") of the Metropolitan Government of Nashville and Davidson County ("Metro"). This policy applies to all financial assets of Metro as cited herein, except for such funds that make up the Knowles Trust Fund and the retirement system portfolio and are allocated to outside money managers, and shall apply to such funds from the time of receipt until the time the funds ultimately leave Metro accounts. These funds include, but are not limited to, all operating funds, bond funds, debt service reserve funds, water and sewer funds, Urban Services District ("USD") and General Services District ("GSD") funds, all Metro operating funds, those pension monies not yet allocated to money managers, all float and certain school funds. The guidance set forth herein is to be strictly followed by all those responsible for any aspect of the management or administration of these funds. This policy supersedes all previous investment policies.

INVESTMENT OBJECTIVES

The Short-Term Investment Portfolio of the Metropolitan Government shall be managed to accomplish the following hierarchy of objectives:

- (1) *Preservation of Principal.* The single most important objective of this investment program is the preservation of the principal of those funds within the portfolio.
- (2) *Maintenance of Liquidity.* The portfolio shall be managed in such a manner that assures that funds are available as needed to meet those immediate and/or future payment requirements of the Metropolitan Government, including but not limited to payroll, accounts payable, capital projects, debt service and any other such payments so designated by the Director of Finance.
- (3) *Maximize Return.* The portfolio shall be managed in such a fashion as to maximize the return on investments but, within the context and parameters set forth by objectives 1 and 2 above.

DELEGATION OF AUTHORITY

The Metropolitan Charter states that, at the approval of the Mayor, the Director of Finance shall instruct the Treasurer to invest funds belonging to Metro. The Treasurer shall be responsible for the investment process, carry out the day-to-day operational requirements and shall maintain written administrative procedures for the operation of the investment program that are consistent with this Investment Policy. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. Metro may employ an Investment Manager to assist in managing some or all of the Portfolio. Such firm must be registered under the Investment Advisors Act of 1940.

INVESTMENT COMMITTEE

The Director of Finance shall establish an Investment Committee consisting of the Director of Finance, Treasurer, and the Chief Accountant. The Committee shall meet periodically, at the call of the Director of Finance to determine general investment strategies, monitor portfolio results, insure the adequacy of maturity restrictions, and perform other duties as may be assigned by the Director of Finance. Further, the Committee will adopt written policies to govern the use of Bankers' Acceptances and Commercial Paper. The committee may establish its own rules of procedure, and may retain the services of a professional investment advisor to assist it in performing its duties.

The Committee shall meet at least quarterly to review the position of the Portfolio and to discuss investment strategies. The Committee will also review investment policies and procedures at least once each year.

No liability shall be attached to any member of the Investment Committee except for misfeasance or malfeasance in the performance of the duties imposed on the Committee in accordance with TCA 6-56-107.

STANDARD OF PRUDENCE

The standard of prudence to be applied to the investment of Metro funds shall be the "Prudent Investor" rule which states;

"Investments shall be made with judgment and care, under circumstances then prevailing which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived."

Portfolio managers (either internal or external) acting in accordance with this policy or any other written procedures pertaining to the administration and management of Metro's

Short-Term Portfolio and who exercise the proper due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided that these deviations are reported in a timely fashion to the Director of Finance and that appropriate action is taken to control and prevent any further adverse developments.

ETHICS AND CONFLICT OF INTEREST

Employees involved in the investment process shall adhere to the Mayor's ethics policy and shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal finance or investment positions that could be related to the performance of the Metro's Portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of Metro.

INTERNAL CONTROLS

The Finance Director shall establish a system of internal controls governing the administration and management of the Short-Term Portfolio and these controls shall be documented in writing. Such controls shall be designed to prevent and control losses of Metro funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by any personnel. The internal controls will address: control of collusion, separation of duties, separating transaction authority from accounting and record keeping, custodial safekeeping, clear delegation of authority, written confirmation of telephone transactions, minimizing the number of authorized investment officials and documentation of transaction strategies.

The Finance Director shall establish an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures.

PERMITTED INVESTMENTS

Metro is empowered by Acts 1943, chapter 23, part 3, subsection 5-8-301 of the Code of the State of Tennessee to invest idle funds to the maximum extent practical in the following securities:

- (1) Bonds, Notes, or Treasury Bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies;
- (2) Certificates of deposit and other evidence of deposit at Tennessee state chartered banks and savings and loan associations and federally chartered banks and savings and loan associations. All investments made pursuant to this subdivision shall be secured in the manner set forth in §§ 5-8-201, 9-1-107, or title 9, chapter 4, parts 1 and 4;

- (3) Obligations of the United States or its agencies under a repurchase agreement for a shorter time than the maturity date of the security itself if the market value of the security itself is more than the amount of funds invested. Counties may invest in repurchase agreements only if the state director of local finance approves repurchase agreements as an authorized investment and if such investments are made in accordance with procedures established by the state funding board;
- (4) The pooled investment fund established by title 9, Chapter 4, part 7;
- (5)(A)
 - (i) Bonds of the State of Tennessee, including any revenue bond issued by any agency of the State, specifically including institutions under the control of the State Board of Education, the Board of Trustees for the University of Tennessee and bonds issued in the name of the State School Bond Authority;
 - (ii) Bonds of any county or municipal corporation of this State, including bonds payable from revenues, but expressly excluding bonds of any road, levee, or drainage district; and
 - (iii) Bonds of any other state or political subdivision thereof.
- (B) Any funds invested pursuant to this subdivision (5) shall be invested only in bonds rated A or higher by any nationally recognized rating service;
- (6) Prime banker's acceptances which are eligible for purchase by the federal reserve system; and
- (7) Prime commercial paper which is rated at least A1 or equivalent by at least two (2) nationally recognized rating services.

Although all of the securities listed above are permitted investments for Metro funds, the Director of Finance may, at his discretion, place further restrictions on the investment of funds in order to achieve the objectives stated in this policy. These additional restrictions will be communicated to the Treasurer, Chief Accountant and Investment Manager through a written Letter of Instructions and may include, among other things, maturity restrictions, additional credit requirements, portfolio composition limitations, diversification criteria and reporting requirements. Further, the Investment Committee will adopt written policies governing the use of bankers' acceptances and commercial paper.

SELECTION, APPROVAL OF BROKERS, QUALIFIED FINANCIAL INSTITUTIONS

Metro will execute security transactions (cash and regular settlement) with (i) primary government securities dealers who report daily to the Federal Reserve Bank of New York or (ii) regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule.)

Brokers and dealers must qualify under the following criteria to be eligible:

- (1) Must have a minimum of \$10,000,000 in capital; and
- (2) Must have been in operation for at least 5 years; and
- (3) Must be reputable among market participants.

The Director of Finance shall maintain a list of financial institutions which are approved for investment purposes. Trades with extended settlement dates will be executed only with firms that meet both the broker/dealer criteria described above and repurchase agreement counterparty criteria as established by the Investment Committee. Written procedures will describe the competitive selection process for financial institutions with whom investment transactions will be conducted.

All brokers, dealers and depositories deemed to be "qualified institutions" shall be provided with current copies of the Investment Policy and any additional instructions from the Director of Finance dealing with the investment of Metro funds. A current audited financial statement is required to be on file for each financial institution and broker/dealer in which Metro invests. In addition, all financial institutions interested in transacting securities trades with Metro are required to complete a "Broker/Dealer Request for Information" as detailed in the Appendix to this policy.

COMPETITIVE SELECTION OF INVESTMENT INSTRUMENTS

It will be the policy of Metro to transact all securities purchases/sales only with approved financial institutions through a formal and competitive process requiring the solicitation and evaluation of at least three bids/offers from qualified local and national financial institutions. Whenever possible, at least one quote shall be solicited from a broker/dealer located in Nashville. Metro will accept the offer which provides (a) the highest rate of return within the maturity required; and (b) optimizes the investment objectives of the overall portfolio. When selling a security, Metro will select the bid which generates the highest sale price.

It will be the responsibility of the personnel involved with each purchase/sale to produce and retain written records of each transaction including the name of the financial institutions solicited, rate quoted, description of the security, investment selected, and any special considerations that had an impact on the decision. If the lowest priced security (highest yield) was not selected for purchase, an explanation describing the rationale will be included in this record.

In making investment decisions, all other things being equal and subject to compliance with any applicable Internal Revenue Code requirements for bond proceeds, investments in

corporations and financial institutions doing business in the State of Tennessee will be given preference over other investment options.

INVESTMENT OF BOND PROCEEDS

Metro intends to comply with all applicable sections of the Internal Revenue Code of 1986, Arbitrage Rebate Regulations and bond covenants with regard to the investment of bond proceeds.

MONITORING AND ADJUSTING THE PORTFOLIO

Those responsible for the day-to-day management of Metro funds will routinely monitor the contents of the portfolio, the available markets and the relative values of competing instruments, and will adjust the portfolio as necessary to meet the investment objectives listed above. It is recognized and understood that this trading of portfolio holdings may cause a book loss on the sale of the owned investment. It is the policy of Metro to charge any such loss against the interest income account.

INVESTMENT POOL

Metro invests funds collectively in order to better meet its investment objectives. In order to assure the stability, safety and liquidity of the investment pool, Metro will follow specific investment and accounting guidelines in managing the investment pool.

- (1) The pool will be managed in a way that should allow it to maintain a constant net asset value (NAV) of \$1.00. However, it is recognized that there can be no assurance that Metro will be able to maintain a constant NAV. The NAV is determined by dividing the value of the net assets of the pool (assets less liabilities) by the total number of shares outstanding.
- (2) The average maturity of the portfolio will be monitored and managed so that changing interest rates will cause only minimal deviations in the NAV.
- (3) The market value of portfolio holdings will be computed on a monthly basis and used to calculate the market value based net asset value of the portfolio. If the market value NAV deviates by more than \$.01 (i.e. falls below \$.99 or rises above \$1.01), the Treasurer will determine what, if any, correction action should be taken to bring the NAV back in line. Until the deviation drops below \$.01, weekly market valuations will be conducted to monitor the portfolio. If the market value NAV falls below \$.98 or rises above \$1.02, the Director of Finance will direct such action as deemed appropriate to eliminate or reduce to the extent reasonably practicable any material

dilution or other unfair results to funds which might arise from any such deviation. This action could include a liquidation of certain portfolio holdings in order to recognize losses/gains and bring the NAV within the \$.99 to \$1.01 range.

- (4) All payments and receipts of income on pool investments will be allocated on a pro rata basis among the accounts invested in the pool. The allocation will be based on the daily invested balance in each fund. Earnings will be calculated and distributed on a monthly basis. Earnings may be transferred to another fund as prescribed by Metro policy.
- (5) Any gains or losses incurred on sales of portfolio holdings will be allocated to funds during the month in which the gain/loss was realized.

COLLATERALIZATION

Collateralization is required on all deposits of Metro funds (including Certificates of Deposit) and by Acts 1990, chapter 702, subsection 9. As per the statute, "required collateral" means collateral whose market value is equal to 105% of the value of the deposit so secured thereby, less so much of such amount as is protected by federal deposit insurance.

The law specifies that the following securities may be pledged as collateral on deposits:

- (1) Bonds of the United States or any of its agencies;
- (2) Obligations guaranteed by the United States or any of its agencies, the payments of which are fully guaranteed both as to principal and interest by the United States;
- (3) Obligations guaranteed by the Tennessee Industrial Development Authority not to exceed the amount of the guarantee;
- (4) Bonds of the State of Tennessee including any revenue bond issued by any agency of the state specifically including institutions under the control of the State Board of Regents, the Board of Trustees of the University of Tennessee and Bonds issued in the name of the State School Board Authority.
- (5) Bonds of any utility district, county or municipal corporation of the State of Tennessee, including bonds payable from revenues (expressly excluding bonds of any road, levee or drainage district) upon which such bonds there has been no default in the payment of interest more than thirty (30) days upon any one (1) installment of interest, for the five (5) years next preceding the deposit of such bonds;

- (6) Loans to students guaranteed one hundred percent (100%) by the Tennessee Student Assistance Corporation, during the dormant period of such loan;
- (7) Bonds issued under the provisions of chapters 37 and 53 of title 7 or under part 3 of chapter 3 of title 48, that are rated "A" or higher by any nationally recognized rating service;
- (8) The State of Tennessee Collateral Pool;
- (9) In addition, the Treasurer with the concurrence of the Commissioner of Finance and Administration and the Commissioner of Financial Institutions, may accept any other collateral security which is acceptable to the Secretary of the Treasury to secure the United States for deposits of public money in tax and/or loan accounts, provided such collateral shall not include state or municipal bonds from other states or from municipalities in other states; or
- (10) For savings and loan associations only, in addition to the eligible collateral listed above, it shall mean an irrevocable letter of credit issued by a Federal Home Loan Bank.

Repurchase agreements must be collateralized by obligations of the United States or any of its agencies for a shorter time than the maturity date of the collateral security itself. The collateral security must have a market value greater than the amount of funds invested.

Although all of the securities listed above may legally be pledged as collateral on Metro deposits and repurchase agreements, the Director of Finance may, at his discretion, place further restrictions on the collateralization of deposits and investments in order to provide additional security against the possibility of loss. Any additional restrictions will be communicated to the Treasurer, Chief Accountant and Investment Manager through a written Letter of Instructions.

SAFEKEEPING AND CUSTODY

All investment securities purchased by Metro or held as collateral on either deposits or investments shall be held in third-party safekeeping at a financial institution (to be designated as the "Custodian") qualified to act in this capacity. All securities held for the Metro account will be held free and clear of any lien and all transactions will be conducted on a delivery-vs.-payment basis. The Custodian shall issue a safekeeping receipt to Metro listing the specific instrument, rate, maturity and other pertinent information. On a monthly basis, the custodian will also provide reports which list all securities held for Metro, the book value of holdings and the market value as of month-end.

Appropriate Metro officials and representatives of the Custodian responsible for, or in any manner involved with, the safekeeping and custody process of Metro shall be bonded in such a fashion as to protect the public from losses from malfeasance and misfeasance.

REPURCHASE AGREEMENTS

Metro will enter into repurchase agreements with approved financial institutions provided that:

- (1) a master repurchase agreement or specific written repurchase agreement approved by the State Director of Local Finance governs the transaction; and
- (2) the securities are held free and clear of any lien by an independent third party acting solely as agent for Metro, and such third party is (i) a Federal Reserve Bank, (ii) a bank which is a member of the Federal Deposit Insurance Corporation and which has combined capital, surplus and undivided profits of not less than \$25 million, and Metro shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for Metro; and
- (3) a perfected first security interest under the Uniform Commercial Code, or book entry procedures prescribed at 31 C.F.R. 306.1 et seq. of 31 C.F.R. 350.0 et seq. in such securities is created for the benefit of Metro; and
- (4) the market value of the collateral including accrued interest must be equal to 102% of the amount of cash transferred by Metro to the dealer bank or security firm under the repo plus accrued interest. If the value of securities held as collateral slips below 102% of the value of the cash transferred, then additional cash and/or acceptable securities must be delivered to the third party custodian; and
- (5) for repurchase agreements with terms to maturity of greater than one (1) day, Metro will value the collateral securities continuously and require that if additional collateral is required then that collateral must be delivered within two business days. If a collateral deficiency is not corrected within this time frame, the collateral securities will be liquidated; and
- (6) the collateral on all repurchase agreements must have a maturity date that exceeds the term of the repurchase agreement.

DIVERSIFICATION

Metro shall diversify the overall portfolio to eliminate the risk of losses from over concentration of assets in a specific class of security, a specific maturity and/or a specific

issuer. Diversification strategies shall be established and revised as necessary by the Director of Finance in accordance with the Investment Policy and communicated to the Treasurer, Chief Accountant and Investment Manager in a written Letter of Instructions.

MAXIMUM MATURITY

To the extent possible, Metro will attempt to match investments with anticipated cash requirements. Nonetheless, investments will be restricted as follows:

- (1) No idle funds are to be invested for a maturity of greater than two (2) years or as otherwise provided by State Statute, however, Metro may collateralize its repurchase agreements using securities with longer maturities.
- (2) Proceeds from the sale of bonds will be invested in compliance with the specific requirements of the bond covenants without further restriction as to the maximum term to maturity of securities purchased.

PERFORMANCE STANDARDS

The investment portfolio shall be designed and managed with the objective of obtaining a market rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and cash flow needs of Metro. The Metro Investment Pool and other funds that must maintain a high degree of liquidity will be compared to the return on the three-month U. S. Treasury Bill and an institutional money market mutual fund with comparable investment restrictions. Medium term investments and other funds that have a longer-term investment horizon will be compared to an index of U. S. Treasury securities having a similar duration or other appropriate benchmark.

REPORTING

The Treasurer shall submit an investment report to the Investment Committee no less than quarterly. This report shall show the change in cost and market value of all invested funds which occurred during the month and will compute the total rate of return for both the internally managed funds and the externally managed funds (if any) for the month, year-to-date, and inception to date. The report shall also describe all securities held in investment portfolios at month-end. Each report shall indicate any areas of policy concern and suggested or planned investment strategy.

The report will also include a statement that the investment of the Portfolio is in compliance with Tennessee Code Annotated, the procedures established by the State Funding Board the State Director of Local Finance, and this Policy.

This policy is adopted this _____ day of _____, 1997.

Metropolitan Treasurer

Director of Finance

Metropolitan Mayor